Mustang Resources Inc.

A NEW BREED OF GROWTH COMPANY
IN THE OIL AND GAS SECTOR

Hitting our Stride

ANNUAL REPORT 2003

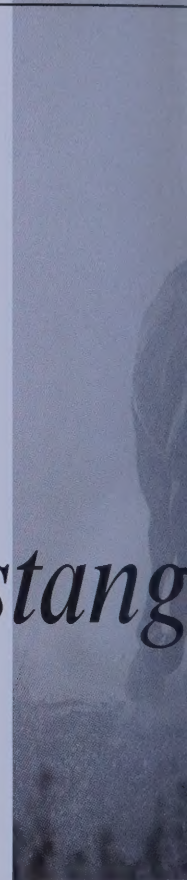
Mustang in Profile

Mustang Resources Inc. is a junior oil and natural gas exploration, development and production Company headquartered in Calgary, Alberta, and operating primarily in Alberta.

Our full-cycle exploration and development strategies have already generated high rates of growth in both production and reserves. Growth per share has been accomplished primarily through the drill bit with some strategic acquisitions within existing or new core areas.

Mustang closed its initial public offering in August 2002 and began trading on September 26, 2002. The Company trades on the TSX – Venture under the symbols MUS.A and MUS.B.

In its first full year, Mustang



Out of the Gate

In 2003, Mustang accomplished the following:

- *Increased proved reserves by 90% to 2.0 million boe*
- *Added proved and probable reserves of 1.6 million boe at a cost of $11.53/boe*
- *Drilled 29 gross (18.5 net) wells with a 69% success rate with 52% of the wells being exploration*
- *Added approximately 1,100 boe/d of production ($17,500 per producing boe)*
- *Replaced production by over 5 times on a proved basis and 6.7 times on a proved plus probable basis*
- *Increased net asset value to $2.90/share, which is a 46% increase over 2002*
- *Finished the year producing approximately 900 boe/d with an additional 700 boe/d behind pipe*

Mustang's annual meeting for its shareholders will take place on June 17, 2004 at 10:30 a.m.
All shareholders are invited to attend the meeting at
The Calgary Petroleum Club, 319 – 5th Avenue SW, Calgary, Alberta.

HITTING OUR STRIDE!

So far in 2004, Mustang has accomplished the following:

- *Acquired for $12.5 million, facilities and production in its core 3D seismic area*
- *Received approval of a $33 million capital budget, which will fund the drilling of 28 gross (18.9 net) wells*
- *Dedicated 95%+ of the 2004 drilling to development drilling with a W5 focus*
- *Closed a $9 million private placement at a price of $4.50/Class A share*
- *Established current production at approximately 1,300 boe/d with an additional 500 boe/d behind pipe*

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A message to our Shareholders

We are pleased to provide an update to our shareholders on Mustang's first full year of operations. Two thousand and three proved to be a milestone year, in which Mustang delivered on its primary objective of increasing per share value for our shareholders. We achieved our targets on all fronts with significant increases in production, reserves, and most importantly, net asset value per share. All were achieved through prospects that were developed in-house and then drilled and operated by Mustang.

Throughout the year, we adhered to our business strategy and its core focus of full-cycle exploration and development drilling in areas that are covered by our large 3D seismic base and that offer high impact multi-zone potential. Consequently, we exited 2003 with a production base of 900 boe/d and an extensive portfolio of development drilling locations that will underpin our production growth in 2004. We also had approximately 700 boe/d of additional production behind pipe that will be brought on stream by the first half of 2004. In total, Mustang added approximately 1,100 boe/d of production at an average cost of approximately $17,500 per flowing boe.

Strategic Acquisition

Mustang's successful 2003 drilling program not only resulted in added production and reserves, but resulted in the Company making a strategic $12.5 million facility and production acquisition in February of 2004. As part of the acquisition, Mustang acquired 220 boe/d of production in the Medicine River, Alberta area and a 100% working interest in a sour oil battery and gas compression facility valued at approximately $5 million. We are in the process of tieing in our 2003 Leduc pinnacle reef discovery well at 8-35-38-4 W5, which tested at various rates of up to 1,000 bbls/d of 44 degree API light oil, into this facility. Mustang has 3D seismic coverage over all of the four existing Leduc pools and sees up to eight potential step-out locations on this property. We also believe that the existing production can be optimized by upgrading the artificial lift systems. Volume adds for the first three new wells and the first three optimized wells are anticipated to be 600 to 1,000 boe/d (100% W.I.) from this acquisition. With success in the three well development program, an additional five development locations could be initiated in the second half of 2004 or early 2005.

Mustang's 2003 capital program was evenly split between exploration and development drilling. As a result of the drilling success achieved in 2003 and the Medicine River acquisition, the Company's 2004 drilling program will be heavily weighted to development drilling. Of the Company's 2004 capital budget of $33 million, approximately $19 million will be directed towards the Medicine River acquisition.

In 2004, we will continue to evaluate acquisition opportunities that could expand our existing core area or launch us into another core area.

Equity Offerings

Mustang participated in three bought deal equity offerings during 2003. In June, the Company completed a $6.0 million financing of 3.1 million Class A shares at $1.95/share. This was followed in October with a $3.3 million, flow-through equity financing of 1.0 million Class A shares at a price of $3.20/share. Near the end of the year Mustang completed an additional $6.6 million financing of 1.5 million Class A shares at a price of $4.40/share. In order to fund the $12.5 million Medicine River acquisition in February 2004, the Company also participated in another bought deal financing for $9.0 million, which resulted in the issue of 2.0 million Class A shares at $4.50/share.

As Mustang's focus is to grow on a per share basis, we will be diligent in using equity strategically to avoid dilution. Mustang currently has only 15.6 million Class A shares outstanding.

Mustang enters 2004 with a very strong balance sheet. The Company exited 2003 with no bank debt. Mustang's bank has just increased its credit facility from $5.4 million to $9.0 million based on the Company's year-end reserve report.

Managed Growth

Mustang has achieved strong growth to date and we are forecasting continued strong production gains in 2004. We will continue to emphasize cost control and to ensure an increasing inventory of drilling opportunities. We will also continue to use debt judiciously and access equity markets in a way that is not overly dilutive. We have added professional staff to handle the demands of our growing Company. In 2003, Mustang added a senior and junior geologist along with an operations technologist to our team, bringing our total staff to 15 full-time employees. This group of dedicated professionals should see us through our continued growth without adding significant new staff.

2004 Outlook

Mustang has a 2004 capital program of $33 million, which should generate production growth in excess of 250% to between 1,700 and 1,900 boe/d average for 2004. Mustang should be able to achieve this production increase without having to significantly dilute the present shareholders. This will translate into increased per share value for Mustang shareholders.

Mustang is in an excellent position to achieve its 2004 goals due in large part to the quality of our professional staff and management team. We also appreciate the strength of our Board of Directors, whose positive guidance has benefited the Company throughout the past year. We look forward to reporting our results through 2004.

On behalf of the Board,

Richard A. M. Todd
President and Chief Executive Officer
April 23, 2004

Exploration success in the first full year of operations

Mustang's first full year of operations resulted in successfully executing an aggressive 29 gross (18.5 net) well-drilling program that included three operated wells drilled to over 3,000 m. Mustang internally generated and operated 55% of our drilling program, which included the majority of our high-impact prospects. As a result of this drilling program, the Company had reserve additions of 1.6 million boe, which resulted in a finding and development cost of $11.53 on a total proved and probable basis.

CENTRAL ALBERTA CORE AREA

Medicine River, Alberta (Leduc Project)

The large 650 sq. mile 3D seismic data base has proven its value to Mustang, by allowing the Company to generate three high-impact Leduc formation prospects that were drilled in 2003. Two of the three prospects were successful and are in the process of being tied in.

The first well drilled was the 07-02-038-04 W5M prospect that targeted an existing pool that had watered out because of poor production practices after producing 0.75 bcf. The 07-02 well was successful and moved 2 m up dip and tested gas at an AOF of 19 mmcf/d. Mustang intends to produce this well conservatively at 1 to 1.5 mmcf/d and has a W.I. of 70%. Mustang's second Leduc well at 06-30-037-03 W5M was wet and has been abandoned.

Mustang's 08-35-038-04 W5M well drilled in September 2003 was drilled to a total depth of 3,169 m and successfully encountered the first new Leduc Pinnacle Reef drilled in the Sylvan Lake area in 15 years. The well tested at rates up to 1,000 bbls/d on a restricted choke. We are planning to have two development locations drilled into this reef in 2004. Mustang has a 50% BPO W.I. and a 35% APO W.I. in the 8-35 discovery well.

Highlights

Medicine River

- *Mustang discovered the first new Leduc Pinnacle Reef drilled in the Sylvan Lake area in 15 years.*
- *Mustang has acquired a 100% working interest in the only sour oil processing facility in the area.*

Ferrybank and Bigoray

- *Mustang discovered two new Mannville pools.*

Clive

- *Mustang initiated its Coal Bed Methane program in 2003 and has 15 to 20 development locations at 100% working interest.*

Focus Areas

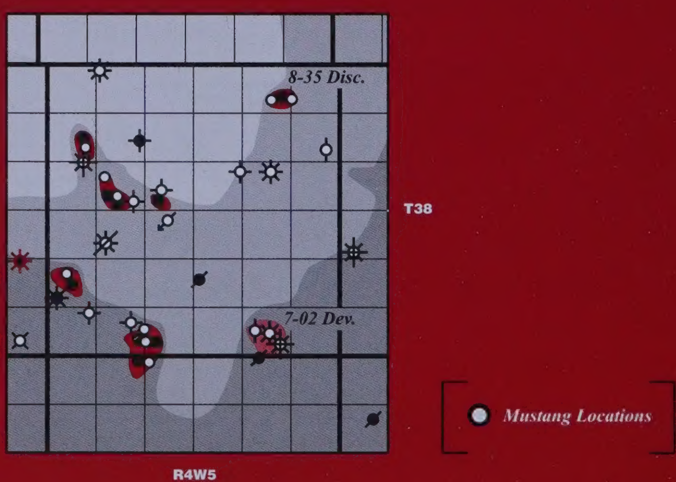
Medicine River, Alberta (Leduc acquisition)

In February 2004, Mustang acquired a 100% W.I. in four additional Leduc producing pools in TWP 038-04 W5M, and also acquired a 100% W.I. in the only sour oil processing facility in the area. Production of 220 bbls/d from seven wells was acquired. Mustang has embarked on an optimization and development drilling program on these four pools. All four pools are covered by Mustang's 3D seismic database, and eight development locations have been interpreted. With the two development locations off-setting our 08-35 discovery, Mustang sits in the enviable position of having ten 3,000-m Leduc development locations in our drilling inventory.

The four producing Leduc pools that were included in the February purchase have approximately 19 million bbls OOIP and, to date, only recovered 17% of the oil. Analogous Leduc pools on the same Leduc trend have recovery factors of 40-90% and are drilled on 40-acre spacing. We believe that, by down-spacing from the existing 160-acre spacing and optimizing the existing production, the recovery factor can be significantly increased. With the large OOIP of 19 million bbls, any increase in the recovery factor will be significant as Mustang has a 100% W.I. in this project.

Mustang's 2004 capital budget includes drilling four of the Leduc development locations and one exploratory Leduc well, and optimizing the production from three existing producing wells.

Medicine River, Leduc Upside



Ferrybank and Bigoray, Alberta

Mustang also discovered two new Mannville pools in our Central Alberta core area, and we are expanding our land positions to further capitalize on these discoveries. At present, three Ferrybank wells are tied in and producing approximately 275 boe/d net to Mustang (100% W.I.). The first discovery well at Bigoray tested at 1.5 mmcf/d (100% W.I.) and a follow-up well has been drilled and completed in March 2004. Both wells will be tied in after spring break-up.

Clive, Alberta

At Mustang's producing property at Clive, a coal bed methane (CBM) project was initiated in 2003. The Clive property sits in a very prospective area of the Horseshoe Canyon Coals, which do not require de-watering to become productive. Mustang initiated its CBM drilling program in 2003 and has drilled five CBM wells to date. The first wells will be on production early in the second quarter of 2004 and an additional 15 to 20 development locations exist on Mustang's 100% W.I. lands. Expected production rates will be 80-150 mcf/d per well. Mustang owns a 100% W.I. in the gathering system and production facilities.

Other

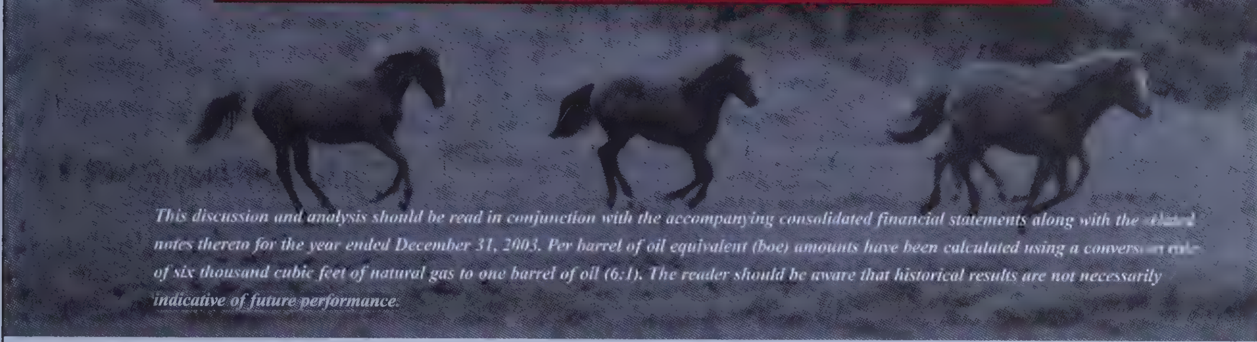
In 2003, Mustang drilled two Pekisko horizontal wells in our Central Alberta core area and both wells are on production and are currently producing 150 boe/d (100% W.I.). Both wells are still being optimized, and further capital expenditures in this project will depend on final production results.

Non-operated areas in Saxon, Chickadee and Carrot Creek in Alberta have added 100 boe/d with five successful wells drilled in 2003 and one dry hole. We anticipate participating in six non-operated wells in this area in 2004 at a W.I. of between 6 to 28%.

Drilling high-impact, internally generated locations

SUMMARY

Mustang has a capital budget of $33 million for 2004, of which approximately $19.1 million will be spent on the acquisition and development of the Medicine River Leduc production purchase. We again look forward to drilling high-impact, internally generated locations and have 95% of our 2004 budget allocated to development drilling.



This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements along with the related notes thereto for the year ended December 31, 2003. Per barrel of oil equivalent (boe) amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil (6:1). The reader should be aware that historical results are not necessarily indicative of future performance.

Certain information regarding the Company contained herein may constitute forward-looking statements under applicable securities laws. Such statements are subject to known or unknown risks and uncertainties that may cause actual results to differ materially from those anticipated or implied in the forward-looking statements. Forward-looking statements are based on the estimates and opinions of Mustang's management at the time the statements were made. Mustang assumes no obligation to update forward-looking statements should circumstances or management's estimates change.

Non-GAAP Measures

The terms "cash flow" and "cash outflow", which are expressed before changes in non-cash working capital, are used by the Corporation to analyze operating performance, leverage and liquidity. These terms do not have any standardized meaning prescribed by Canadian Generally Accepted Accounting Principles (GAAP) and therefore might not be comparable with the calculation of a similar measure for other companies.

Petroleum and Natural Gas Sales

For the year ended December 31, 2003, petroleum and natural gas sales increased to $9.35 million as compared to $0.76 million for the six-month period ended December 31, 2002.

Petroleum and Natural Gas Sales

($000s)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Natural gas sales	**7,142**	482	1,382
Oil sales	**1,352**	129	948
NGL sales	**857**	101	749
	9,351	712	1,213
Other	–	48	(100)
Total petroleum and natural gas sales	**9,351**	760	1,130

The increase in petroleum and natural gas sales in 2003 was a result of increased production volumes in 2003 as compared to 2002. Mustang did not have any production in 2002 until it acquired the natural gas and oil properties in Central Alberta on November 18, 2002.

Average Commodity Prices

(6:1 conversion)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Natural gas *($/mcf)*	**6.62**	5.97	13
Oil *($/bbl)*	**39.82**	41.92	(3)
NGL *($/bbl)*	**36.90**	34.88	7
Total *($/boe)*	**39.48**	36.76	10

Mustang received marginally higher commodity pricing in 2003 as compared to 2002, mainly as a result of natural gas prices being up approximately 13%. Overall, the Company's 2003 price per boe was up 10% over 2002. The Company did not have any commodity hedges in place at December 31, 2003. On February 6, 2003, Mustang entered into a natural gas costless collar for a volume of 1,000 GJ/d with a floor price of $4.75/GJ and a ceiling of $9.60/GJ for the period from April 1, 2003, to November 1, 2003. The costless collar has expired, and it had no effect on the 2003 natural gas price.

Mustang assumed two aggregator contracts for the sale of natural gas for two properties that were acquired in November 2002. These aggregator contracts are tied to natural gas production from specific wells and will result in Mustang receiving prices that may vary from AECO daily index pricing on these volumes. The volumes subject to the aggregator contracts at year-end were approximately 700 mcf/d; however, this volume will vary with the production from the specific wells and properties subject to the aggregator contracts.

Average Daily Production

(6:1 conversion)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Natural gas *(mcf/d)*	**2,954**	446	562
Oil *(bbls/d)*	**93**	17	447
NGL *(bbls/d)*	**64**	16	300
Total *(boe/d)*	**649**	107	507

Projecting into 2004, Mustang is expecting substantially higher petroleum and natural gas sales as compared to 2003. The higher revenues are expected to be achieved as a result of higher average production volumes. We currently expect Mustang's production for 2004 to average 1,700 to 1,900 boe/d. At the present time, the Company is currently receiving higher oil prices as compared to 2003, however, these prices are expected to moderate over the year. Given that Mustang has not hedged or fixed any of its commodity prices at the present time, the prices received by the Company will fluctuate along with market prices for the various commodities.

Royalty Expenses

Royalties

($000s)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Crown	**$ 1,667**	$ 108	1,444
Freehold and GORR	**430**	14	2,971
ARTC	**(31)**	–	–
Total royalties	**$ 2,066**	$ 122	1,593

The increase in royalties for the year ended December 31, 2003, is a result of the increase in the petroleum and natural gas sales as compared to the six-month period ended December 31, 2002. Mustang did not receive any Alberta Royalty Tax Credit (ARTC) in 2002 since all the properties acquired in 2002 were restricted properties for ARTC purposes. The ARTC received in 2003 related to royalties paid on new wells drilled in 2003.

Average Royalty Rate

(Average % of sales)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Crown	**17.8**	15.2	17
Freehold and GORR	**4.6**	2.0	130
ARTC	**(0.3)**	–	–
Total royalties	**22.1**	17.2	28

The average royalty rate for the year ended December 31, 2003, increased to 22.1% as compared to 17.2% for the six-month period ended December 31, 2002. The increase was a result of a higher percentage of the Company's overall production coming from crown lands which generally have higher average royalty rates as compared to freehold lands. The freehold and GORR rate increased in 2003 as compared to 2002 as additional production was acquired and brought on stream in the Clive, Alberta area, which is mainly freehold in nature.

In 2004, we expect Mustang's total royalties to increase along with the expected increase in total petroleum and natural gas sales. The 2004 average royalty rate should be consistent with the 2003 average royalty rate.

Production Expenses

Production Costs

($000s, except per boe)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Production expense (gross)	**$ 2,246**	$ 189	1,088
Processing income	**(399)**	(48)	731
Production expense (net)	**1,847**	141	1,210
Production expense per boe (net)	**$ 7.80**	$ 7.12	10

Production expenses for the year ended December 31, 2003, increased to $2.2 million as compared to $0.2 million for the six-month period ended December 31, 2002. The increase was a result of the increased production volumes in 2003. On a per unit basis, 2003 production expenses increased 10% to $7.80/boe as compared to 2002. The 2002 amount of $7.12/boe was essentially for one month of production, the month of December, and is not comparable to 2003, which represents a 12-month period. Since the majority of the Company's 2003 production was non-operated, it had a limited ability to reduce costs. This will change in 2004 as Mustang will be bringing on additional production that Mustang will be operating and, as a result, will have a greater ability to reduce costs.

In 2004, we expect Mustang's total production expense to increase as a result of increases in production. However, we expect net production expense per boe will decrease in 2004 due to the impact of lower-cost production coming on stream. In addition, most of Mustang's expected drilling in 2004 will take place on land where Mustang has access to its own facilities. This general trend of reducing per-unit production expenses will be offset somewhat by an expected inflationary increase in costs.

Operating Netback

($/boe, 6:1 conversion)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Sales price	**$ 39.48**	$ 36.04	10
Royalties	**(8.72)**	(6.18)	41
Production expense	**(7.80)**	(7.12)	10
Operating netback	**$ 22.96**	$ 22.74	1

The 2003 netback was comparable to the 2002 netback. The modest increase in the 2003 commodity prices was offset by the higher royalty rates and operating costs on a per-unit basis.

Mustang expects the 2004 netback to be comparable with the 2003 netback.

General and Administrative (G&A) Expenses

($000s, except per boe)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
G&A expenses (gross)	**$ 2,564**	$ 545	370
Overhead recoveries	**(515)**	(154)	234
Capitalized G&A	**(356)**	(83)	329
G&A expense (net)	**1,693**	308	450
G&A expense per boe (net)	**$ 7.15**	$ 15.90	(55)

For the year ended December 31, 2003, general and administrative expenses increased 450% to $1.69 million from $0.3 million for the six-month period in 2002. On a per unit basis, general and administrative costs decreased 55% to $7.15/boe in 2003 as compared to 2002. The decrease was a result of additional production volumes coming on stream in 2003.

The capitalized general and administrative expenses related solely to the Company's exploration and development program.

Mustang expects 2004 general and administrative expenses to continue to decrease significantly on a per-unit basis as the Company plans to increase average production volumes to between 1,700 and 1,900 boe/d in 2004.

Interest Expense

Interest expenses for the year ended December 31, 2003, were $168,498 (2002 – nil), which consisted of $11,635 for interest on bank debt and $156,863 for interest charged by Canada Revenue Agency (CRA). CRA assesses a monthly interest charge on the unexpended flow-through funds that are required to be expended on qualifying exploratory expenditures by December 31, 2003. The interest charge commenced February 1, 2003 with the CRA imputed rate being 5% for the majority of the year. The interest on bank debt was minimal as the Company funded its 2003 capital program mainly by issuing equity and utilizing internal cash flows.

Mustang expects interest expenses to increase significantly in 2004 as the Company plans to use its credit facility to fund a portion of its 2004 capital program.

Depletion, Depreciation and Site Restoration

Depletion, depreciation and site restoration charges calculated on a unit of production method are based on total proved reserves with a conversion of 6,000 cubic feet of natural gas being equivalent to 1 barrel of oil. The 2003 depletion calculation includes $2,643,700 (2002 – $570,000) of future capital expenditures to develop the Company's reserves but excludes $2,107,000 (2002 – $1,697,000) of unproven properties relating to undeveloped land.

Depletion and depreciation charges increased to $2,812,000 for the year ended December 31, 2003, as compared to $136,300 for the six-month period ended December 31, 2002. The 2003 increase was a result of the increased production in 2003. On a per-unit basis, depletion and depreciation charges were $11.87/boe as compared to $7.04/boe for 2002. The 69% increase over 2002 is attributable to the increased finding costs for 2003. For reporting purposes, NI 51-101 has affected the level of reserves assigned to proved wells. All of the Company's 2003 capital program occurred in the second half of the year. As a result, very little or no production history has been obtained from many of the Company's successful wells. Under the requirements of NI 51-101, new wells receive limited proved reserves until sufficient well production history is available. The standard for booking proved reserves requires that the expected recoverable volumes be estimated with a high degree of certainty (90% or more certainty). Under the standard, it is likely that the actual remaining reserves recovered will exceed the present estimated proved reserves. Possible revisions resulting from increased certainty in future years will reduce cumulative average finding costs per boe.

Site restoration charges increased to $214,600 for the year ended December 31, 2003, as compared to $23,000 for the six months ended December 31, 2002. The increase was again a result of production increasing in 2003. On a per-unit basis, site restoration charges was $0.91/boe for 2003 compared to $1.19/boe for 2002.

Depreciation on other assets in 2003 was $38,700 as compared to $19,500 for 2002. The increase was a result of 2003 consisting of 12 months, whereas 2002 only consisted of six months.

Income Taxes

($000s)	**2003**	2002
Current income tax	**$ 28**	$ –
Future income taxes	**287**	41
Total income taxes	**$ 315**	$ 41

The Company uses the liability method of income tax allocation for income taxes. The provision for future income taxes for the year ended December 31, 2003, was $287,222 (2002 – $40,685). With the exception of the federal large corporations tax of $27,784 (2002 – $nil), Mustang had no current income taxes in 2003.

Mustang expended $19.2 million on capital in 2003 (2002 – $7.6 million), of which $8.6 million (2002 – $1.4 million) had no associated tax pools due to the flow-through share renouncements. This balance comprises $6.8 million for the December 2002 renouncement and $1.8 million of expenditures related to the $3.3 million October 2003 flow-through. With budgeted capital expenditures of $33 million in 2004, Mustang expects that it will have sufficient tax pools to offset the related 2004 current tax liability. Of the 2004 budgeted capital expenditures, $1.5 million will have no associated tax pools as this represents the unexpended December 31, 2003, balance related to the October 2003 flow-through. Taxes payable beyond 2004 will become a function of commodity prices, production volumes and capital expenditures.

Income Tax Pools at December 31

($000s)	**2003**	2002	Rate of Claim
Canadian oil and gas property expense	**$ 5,832**	$ 4,439	10%
Undepreciated capital cost	**2,970**	1,236	20 – 30%
Canadian development expense	**5,853**	21	30%
Canadian exploration expense	**19**	56	100%
Non-capital losses	**346**	346	100%
Share issue costs	**1,484**	666	20%
Total	**$ 16,504**	$ 6,764	

Cash Flow and Net Earnings

($000s except per share data)	**2003**	2002
Cash flow from operations	**$ 3,616**	$ 249
Per basic share	**0.34**	0.03
Per diluted share	**0.29**	0.02
Net earnings	**263**	29
Per basic share	**0.02**	0.00
Per diluted share	**$ 0.02**	$ 0.00

The increase for both the net earnings and cash flow from operations is due primarily to Mustang having a full year of production in 2003. Based on the Company's forecasted average 2004 production of 1,700 to 1,900 boe/d, Mustang anticipates 2004 cash flow to be approximately $12 million.

Mustang follows the full-cost method of accounting. Under this method, both successful and unsuccessful wells are added to the capital base and depleted at the rate of production over the remaining oil and natural gas reserves. A ceiling test is then employed to ensure that the carrying value of property and equipment in the financial statements does not exceed the undiscounted estimated future net revenue from proved reserves. For the year ended December 31, 2003, no write-down was required as Mustang's carrying value of property and equipment exceeded the undiscounted estimated future net revenue from proved reserves.

Capital Expenditures

($000s)	**December 31, 2003 (12 months)**	December 31, 2002 (6 months)	%
Drilling and completions	**$ 14,031**	$ 1,318	965
Facilities and equipment	**2,236**	4	55,800
Property acquisitions	**1,917**	5,681	(66)
Land	**609**	419	45
Geological and geophysical	**366**	95	285
Other	**45**	131	(66)
Total	**$ 19,204**	$ 7,648	151%

Mustang's capital expenditures increased substantially in 2003 over 2002 because 2003 was the Company's first full year of operations. The Company drilled 29 gross (18.5 net) wells in 2003 as compared to seven gross (2.6 net) wells in 2002. The Company's initial acquisition of oil and natural gas properties in Central Alberta formed the majority of the capital spent in 2002.

Mustang's capital program for 2004 is budgeted to be $33 million, which includes $12.5 million for a production and facilities acquisition which closed in February 2004. The Company plans on drilling 28 gross (18.9 net) wells in 2004.

Drilling Results

	2003		2002	
	Gross	**Net**	Gross	Net
Gas	**14**	**7.7**	3	1.1
Oil	**4**	**2.8**	–	–
Suspended	**2**	**0.9**	1	0.5
Dry and abandoned	**9**	**7.1**	3	1.0
Total	**29**	**18.5**	7	2.6

During 2003, Mustang drilled 29 wells (18.5 net) of which 15 (12.8 net) were exploration wells and the remaining 14 (5.7) were development wells. Of the 28 (18.9 net) wells planned for 2004, 26 (18.0) wells will be development wells with the remaining two (.9) wells being exploration. The drilling in 2004 will follow up on the exploration successes achieved in 2003 and thus, will focus much more on development drilling.

Finding and Development Costs

NI 51-101 specifies how finding and development ("F&D") costs should be calculated if they are reported. NI 51-101 requires that the exploration and development costs incurred in the year along with the change in estimated future development costs be aggregated and then divided by the applicable reserve additions. The calculation excludes the effects of acquisitions and dispositions on both reserves and costs. For reporting purposes, NI 51-101 has affected the level of reserves assigned to proved wells. Most of the Company's 2003 capital program occurred in the second half of the year. As a result very little or no production history has been obtained from many of the Company's successful wells. Under the requirements of NI 51-101, new wells receive limited proven reserves until sufficient well production history is available. The standard for booking proved reserves requires that the expected recoverable volumes be estimated with a high degree of certainty (90% or more certainty). Under the standard, it is likely that the actual remaining reserves recovered will exceed the present estimated proved reserves. Possible revisions resulting from increased certainty in future years will reduce cumulative average finding costs per boe.

F&D Costs Calculation

	Exploration and development costs *($000)*	Change in future development costs *($000)*	Total costs *($000)*	Reserve additions *(mboe)*	**2003 F&D costs *($/boe)***
Proved	17,345	2,077	19,422	1,150	**16.89**
Proved plus probable	17,345	529	17,874	1,551	**11.53**

Mustang believes it is informative to show Finding, Development and Acquisition (FD&A) costs since acquisitions can have a significant impact on the company's reserve replacement costs. The majority of the reserve additions in 2002 were acquisition related and the majority of the 2003 reserve additions were drilling related. As such the following table shows the company's FD&A costs since inception (July 1, 2002):

FD&A Costs Calculation

	Total capital costs *($000)*	Future development costs *($000)*	Total costs *($000)*	Reserve additions *(mboe)*	**2003 FD&A costs since inception *($/boe)***
Proved	26,780	2,647	29,427	2,287	**12.87**
Proved plus probable	26,780	2,729	29,509	3,105	**9.50**

Recycle Ratio

A key indicator for evaluating a company's reinvestment program is the recycle ratio. The ratio is one measure of the efficiency of capital investment. The ratio is determined by dividing the operating netback per barrel of oil equivalent by the current year's reserves finding and development costs.

2003	**$/boe**	**Recycle Ratio**
Operating netbacks	**22.96**	
Current year F&D costs		
Proved	**16.89**	**1.4**
Proved plus probable	**11.53**	**2.0**

As mentioned previously, Mustang believes that the recycle ratio should also be calculated based on finding, development and acquisition costs since inception.

Since inception (July 1, 2002)	$/boe	Recycle Ratio
Operating netbacks	22.94	
Current year F&D costs		
Proved	12.87	1.8
Proved plus probable	9.50	2.4

Undeveloped Land

The Company's undeveloped lands were evaluated independently by Seaton-Jordan & Associates Ltd.

	December 31, 2003	December 31, 2002	% Change
Gross acres	**57,968**	52,205	11
Net acres	**22,353**	16,237	38
Average working interest	**39%**	31%	26
Value	**$ 3,224,971**	$ 2,858,382	13

For the year ended December 31, 2003, Mustang spent approximately $549,000 (2002 – $417,000) on crown land sales. Of the undeveloped land position at December 31, 2003, approximately 6,800 gross (3,000 net) acres will expire in 2004.

Reserves and Future Net Revenue

McDaniel & Associates Consultants Ltd. (McDaniel) independently evaluated the Company's reserve base in accordance with the requirements of NI 51-101 in a report effective December 31, 2003. The report was approved by the Company's reserve committee and also Mustang's Board of Directors.

Over 99% of the Company's reserves are in Alberta. Natural gas volumes are converted to an oil equivalent basis using a conversion factor of 6,000 cubic feet of gas to 1 barrel of oil.

As of December 31, 2003, Mustang's proved and probable reserve base was 2,857,400 bbls of oil equivalent. Natural gas accounted for 56% of the reserve base, crude oil 35% and natural gas liquids 9%. Total proved reserves represented 71% of the total proved and probable reserves.

Mustang's proved reserve base was 2,039,000 boe. Proved producing reserves represent 45% of the total proved reserve base. Proved non producing reserves of 820,300 boe make up 40% of the total proved reserve base, while proved undeveloped reserves make up the remaining 15%. Future capital costs required to develop the proved non producing reserves are estimated to be $1,211,700. Mustang believes that it will have the majority of the proved non producing reserves on production by the end of June 2004. Future capital costs required to develop the proved undeveloped reserves are estimated at $1,422,500. The majority of the proved undeveloped reserves relates to two development locations offsetting the Company's Leduc discovery well at 8-35-38-4 W5M. Mustang plans on drilling these two locations in 2004.

Crude oil reserves range in API gravity from 28 to 44 degrees with no heavy oil reserves.

The following table is a summary of Mustang's petroleum and natural gas reserves and present net worth of future cash flows associated with such reserves as evaluated by McDaniel. It is important to note that these estimates are subject to positive and negative revisions as additional reservoir and production information becomes available. The reserves attributed to Mustang are based on judgments regarding future events; therefore, actual results will vary and the variations may be material. There is no assurance that prices used and cost assumptions will be attained and variances could be material. All estimated future cash flows are stated before income taxes and indirect costs but after operating costs, royalties, estimated future capital expenditures and estimated abandonment costs. The McDaniel report is based on certain factual data supplied by the Company and McDaniel's opinion of reasonable industry practice.

The present net worth of estimated future cash flows contained in the following table may not be representative of the fair market value of the reserves:

Reserves Summary at December 31, 2003

	Reserve Volumes				Present Value of Future Cash Flows Discounted at Rates of				
	Crude Oil *(mbbls)*	NGLs *(mbbls)*	Natural Gas *(mmcf)*	Oil Equiv. *(mboe)*	0% *($000s)*	5% *($000s)*	10% *($000s)*	15% *($000s)*	20% *($000s)*
Proved developed producing	202	99	3,709	919	17,293	15,347	13,853	12,675	11,725
Proved developed non producing	257	81	2,897	820	15,340	14,027	13,043	12,251	11,585
Proved undeveloped	247	14	230	300	5,337	4,788	4,326	3,933	3,596
Total proved	**706**	**194**	**6,836**	**2,039**	**37,970**	**34,162**	**31,222**	**28,859**	**26,906**
Probable	**294**	**75**	**2,692**	**818**	**15,161**	**12,031**	**9,912**	**8,390**	**7,248**
Total proved-plus-probable	**1,000**	**269**	**9,528**	**2,857**	**53,131**	**46,193**	**41,134**	**37,249**	**34,154**

Reserve volumes are before the deduction of royalty interests. The Alberta Royalty Tax Credit is included in the reserve values. The following is a summary of the McDaniel's April 1, 2004 price forecast used:

	Crude Oil		Natural Gas	
Year	WTI Cushing, Oklahoma *($US/bbl)*	Edmonton Par Price *($Cdn/bbl)*	Henry Hub *($US/mmbtu)*	Alberta Plantgate Index *($Cdn/mmbtu)*
2004 *(3 months)*	35.00	46.00	6.00	6.40
2004 *(9 months)*	34.00	44.30	5.45	6.25
2005	29.00	37.60	5.00	5.80
2006	27.00	35.00	4.50	5.20
2007	25.50	32.90	4.15	4.85
2008	25.50	32.90	4.10	4.75
2009	26.00	33.60	4.15	4.80
2010	26.50	34.20	4.25	4.95
2011	27.00	34.90	4.35	5.05
2012	27.50	35.50	4.40	5.10
2013	28.10	36.30	4.50	5.25
2014	28.70	37.00	4.60	5.35
2015	29.30	37.80	4.70	5.50
2016	29.90	38.60	4.80	5.60
2017	30.50	39.40	4.90	5.75
2018	31.10	40.10	5.00	5.85
2019	31.70	40.90	5.10	5.90
2020	32.30	41.70	5.20	6.05
2021	32.90	42.50	5.30	6.15
2022	33.60	43.40	5.40	6.30
Thereafter	34.30	44.30	5.50	6.40

Liquidity and Capital Resources

At December 31, 2003, Mustang had cash of approximately $4.9 million (2002 – $2.1 million) and a working capital deficiency of $5.0 million (2002 – $1.3 million), excluding cash. The Company had no bank debt.

During the past year, Mustang closed the following three private placements:

Equity Issues

	Date of issue	Price per share	Shares Issued	Gross Proceeds
Class A shares	June 17, 2003	$ 1.95	3,100,000	$ 6,045,000
Class A shares	October 2, 2003	$ 3.20	1,031,250	3,300,000
Class A shares	December 19, 2003	$ 4.40	1,500,000	6,600,000
Total			5,631,250	$ 15,945,000

The net proceeds of the various equity issues along with Mustang's internal cash flow were used to fund the Company's 2003 capital program of approximately $19.2 million. During 2003, 10,000 stock options were exercised for total proceeds of $3,500.

At December 31, 2003, Mustang had a $5.4 million revolving production loan facility with a major Canadian chartered bank. Subsequent to year-end Mustang signed a letter of intent to increase the loan facility to $9.0 million subject to bank approval.

On February 19, 2004, Mustang closed an additional equity private placement that generated gross proceeds of $9.0 million. This equity issue will keep Mustang under its guideline of 1.5 times forward cash flow and maintain its under leveraged balance sheet.

Net Asset Value

Mustang's fully diluted net asset value per share has grown 46% from $1.99/share at December 31, 2002 to $2.90/share at December 31, 2003. (Both calculations are made converting Mustang's Class B shares into Class A shares on a 1:1 basis.)

($000s, except per share)	**December 31, 2003**	December 31, 2002	Inception (August 21, 2002)
Reserve value discounted at 10% before tax *(note 1)*	**$ 41,134**	$ 16,341	$ –
Undeveloped land	**3,225**	2,858	–
Working capital (deficiency)	**(142)**	782	8,133
Property acquisition subsequent to year-end *(note 2)*	–	(1,144)	–
Proceeds from exercise of options and warrants	**1,588**	888	292
Total	**$ 45,805**	$ 19,725	$ 8,425
Fully diluted outstanding shares *(note 3)*	**15,773**	9,927	9,526
Net asset value per fully diluted share	**$ 2.90**	$ 1.99	$ 0.88

Note 1: Reserve value at December 31, 2003, includes total proved and probable reserves. Reserve value at December 31, 2002, includes total proved and 50% of probable reserves.

Note 2: In February 2003, Mustang acquired additional natural gas reserves in Clive, Alberta, which were included in the Company's December 31, 2002, reserve report.

Note 3: Converting the Class B shares into Class A shares on a 1:1 basis.

Assuming Class B shares are converted into Class A shares at the last 30-day weighted average trading price of Class A shares being $4.46 (2002 – $1.78), the fully diluted net asset value per share is $2.74 (2002 – $1.48) at December 31, 2003.

Business Risks and Prospects

Mustang is exposed to several operational risks inherent in exploring, developing and marketing crude oil and natural gas. These risks include:

- the economic risk of finding and producing reserves at a reasonable cost;
- the financial risk of marketing reserves at an acceptable price given market conditions;
- equipment shortages;
- the cost of capital risk associated with securing the needed capital to carry out the Company's operations; and
- the risk of carrying out operations with minimal environmental impact.

Mustang strives to manage or minimize these risks in a number of ways, including

- employing qualified professional and technical staff;
- concentrating its activities in a limited number of areas with low cost exploration and development objectives;
- reducing high-risk exploration exposure through joint-venture relationships;
- utilizing the latest technology for finding and developing reserves;
- constructing quality, environmentally sensitive, safe production facilities;
- maximizing operational control of drilling and producing operations; and
- adhering to conservative borrowing guidelines.

Mustang also carries environmental liability, business interruption, property and general liability insurance. The insurance program is maintained to mitigate risks and to protect against significant losses, while maintaining levels of risk within the Company that management believes to be acceptable. While Mustang believes that its liability, property and business interruption insurance is adequate and consistent with industry participants of Mustang's size, the Company is unable to obtain insurance to cover all risks within the business or in amounts to cover all claims.

Both oil and natural gas prices are extremely volatile and very difficult to predict. Significant downward fluctuations in the price of oil and natural gas may have a significant negative impact on Mustang's revenue. Significant upward fluctuations in commodity pricing may increase competition in the industry and restrict Mustang's ability to compete cost effectively. Mustang will monitor and, when appropriate, may utilize derivative financial instruments and physical delivery contracts to hedge its exposure to commodity price fluctuation risks. However, there are many risks inherent in any commodity hedging program, including counter-party risk, foregoing increases in price above the hedge price, margin calls, inability to provide for the required physical delivery of the commodity, paying royalties on a higher market or reference price and negative public market sentiment on an out-of-the-money hedging program. At the present time, Mustang does not have any hedging programs in place.

Mustang's operations may be adversely affected by changes in governmental policies, regulations or taxation for the Canadian oil and natural gas industry. Changes in any of these areas may significantly increase Mustang's costs or adversely affect the Company's ability to conduct business.

Mustang uses independent engineering experts when determining its reserve additions. Because of the short or no production history on a large percentage of our projects, the reserves assigned and production forecasts related to the majority of the Company's projects have been based on volumetric calculations and production test data, therefore, the ultimate performance and reserves are subject to variability. Over time, as production history is gained, it is expected that the variability of these forecasts will lessen.

Mustang's operations are highly dependent upon its executive officers and key personnel. The unexpected loss of the services of any of these individuals could have an adverse impact on Mustang.

Health, Safety and Environmental Policy

The health and safety of employees, contractors and the public, as well as the protection of the environment, is of utmost importance to Mustang. The Company endeavours to conduct its operations in a manner that will minimize both adverse effects and consequences of emergency situations by:

- complying with government regulations and standards;
- operating consistent with industry codes, practices and guidelines;
- ensuring prompt, effective response and repair to emergency situations and environmental incidents;
- providing training to employees and contractors to ensure compliance with Company safety and environmental rules and procedures; and
- communicating openly with members of the public regarding our activities.

Mustang believes that all employees have a vital role in achieving excellence in environmental, health and safety performance. This is best achieved through careful planning and the support and active participation of everyone involved.

Outlook

Mustang enters 2004 well positioned to continue to generate solid, sustainable per share growth for its shareholders. In its first 18 months of operation, Mustang has assembled a quality reserve base comprising 2.9 million boe of proved and probable reserves and approximately 22,000 net acres of undeveloped land.

Mustang closed a strategic $12.5 million production and facilities acquisition in February 2004 in its core Medicine River, Alberta area. As part of the acquisition, Mustang has acquired a 100% working interest in a sour oil battery and gas compression facility valued at approximately $5 million. Mustang will be tying in its Leduc Pinnacle Reef discovery well at 8-35-38-4 W5, which tested at various rates of up to 1,000 bbls/d, into this facility. Mustang has 3D seismic coverage over all of the existing producing pools and sees up to eight potential step-out development locations. We also believe that the existing production of approximately 220 boe/d can be optimized by upgrading the artificial lift systems. Approximately 62% of Mustang's 2004 capital budget has been allocated to this acquisition property.

Mustang will continue to seek opportunities to acquire, at reasonable costs, complementary assets that fit into its strategy to increase Mustang's reserve and production base on a per share basis.

Fourth Quarter – 2003

Financial and operating highlights from Mustang's fourth quarter of 2003 along with the comparative three-month period of 2002 are noted below.

Financial Highlights	3 Months Ended December 31		
($000s, except where noted)	**2003**	2002	%
Petroleum and natural gas sales	**$ 2,471**	$ 760	225
Other income	**26**	33	(21)
Royalties	**(574)**	(122)	370
Production expense	**(604)**	(141)	328
General and administrative expense	**(625)**	(226)	177
Interest expense	**(11)**	–	100
Capital taxes	**(27)**	–	(100)
Cash flow from operations	**656**	304	116
Depletion, depreciation and site restoration	**(1,526)**	(179)	(753)
Future income tax	**370**	(41)	1,002
Net earnings (loss)	**$ (500)**	$ 84	(695)
Average sales price *(6:1 conversion)*			
Natural gas *($/mcf)*	**5.75**	5.87	(2)
Crude oil *($/bbl)*	**36.95**	40.97	(10)
NGL *($/bbl)*	**37.61**	34.61	9
Total *($/boe)*	**35.21**	36.04	(2)
Average daily production *(6:1 conversion)*			
Natural gas *(mcf/d)*	**3,337**	892	274
Crude oil *(bbls/d)*	**138**	34	306
NGL *(bbls/d)*	**61**	32	91
Total (*boe/d*)	**763**	215	255

The large increases in petroleum and natural gas sales, royalties and operating costs in the fourth quarter of 2003 were a result of increased production volumes in 2003 as compared to 2002. Mustang did not have any production volumes in 2002 until it acquired natural gas and oil properties in Central Alberta on November 18, 2002. Mustang's capital expenditures in the fourth quarter of 2003 amounted to $8,772,000 as compared to $7,408,450 for the comparative three-month period of 2002. During the fourth quarter of 2003, Mustang drilled 12 gross (10.1 net) wells compared to six gross (2.4 net) wells drilled in the fourth quarter of 2002. The majority of Mustang's capital expenditures in the fourth quarter of 2002 related to the $5.7 million property acquisition in November 2002.

The large increase in depletion and depreciation charges in the fourth quarter of 2003 resulted from increased production and increased finding costs for 2003 as a result of the year-end reserve report that was completed under NI 51-101. For reporting purposes, NI 51-101 has affected the level of reserves assigned to proved wells. Please see the Depletion, Depreciation and Site Restoration section.

The large increase in general and administrative expenses for the fourth quarter of 2003 was a result of the Board of Directors approving 2003 employee year-end bonuses of $270,223.

The increased depletion and depreciation charges along with the increased general and administrative expenses in the fourth quarter of 2003 resulted in the Company incurring a fourth-quarter loss in 2003.

Impact of New Accounting Pronouncements

In December 2002, the Accounting Standards Board approved a standard on accounting for asset retirement obligation effective for fiscal years beginning on January 1, 2004. The standard requires the recognition of a liability for obligations associated with the retirement of property, plant and equipment when the liability is incurred. The liability would be recognized initially at fair value (obligation is discounted using the credit-adjusted risk-free interest rate), and the resulting amount would be capitalized as part of the asset. In subsequent periods, the Company would recognize accretion on the liability, and adjust the carrying amount of the asset and the liability for changes in estimates of the amount or timing of cash flow. Under existing standards, the liability for future removal and site restoration costs is recognized using a cost-accumulation measurement over the useful life of the asset accrued over the life of the asset and the obligation is not discounted. Mustang is currently assessing these requirements to ensure it complies with the new standards.

In December 2002, the Accounting Standards Board approved an amendment to the Handbook Section, Stock-Based Compensation effective for fiscal years beginning on or after January 1, 2004. The amendment requires all stock options to be expensed at fair value. Under existing standards, companies have the option of disclosing this information in the notes to the financial statements rather than expensing stock options. The Company will be adopting the requirements in 2004 retroactively without restatement. The charge to Retained Earnings on January 1, 2004, will be $0.4 million.

In September 2003, the Accounting Standards Board issued an amendment to its accounting guideline "Full Cost Accounting in the Oil and Gas Industry", effective for fiscal years beginning on or after January 1, 2004. Under the new guideline, the ceiling test would involve a two-step process. The first step would determine whether a write-down is required by comparing the carrying value of the properties to the undiscounted cash flow of the proved reserves (based on management's best estimate of future prices) plus the lower of cost and market value of unproved properties. If a Company fails the first step, the carrying value of the properties will be written down to the discounted value of the proved plus probable reserves (based on management's best estimate of future prices) plus lower of cost and market of unproved properties. Under existing standards, the undiscounted cash flow amount is based on the commodity prices existing at the balance sheet date. Mustang is currently assessing these requirements to ensure it complies with the new guidelines.

Quarterly Financial Information

The following is a summary of selected quarterly information that has been derived from the unaudited financial statements of Mustang. The summary should be read in conjunction with the unaudited financial statements of Mustang as contained in the public record.

Quarterly Information

	2002		2003			
	Q3	Q4	Q1	Q2	Q3	Q4
Financial *($000s, except per share amounts)*						
Petroleum and natural gas sales	$ –	$ 760	$ 2,292	$ 2,126	$ 2,462	$ 2,471
Cash flow from operations	(56)	304	1,096	866	998	656
Cash flow per share (basic)	(0.01)	0.03	0.13	0.09	0.08	0.05
Capital expenditures	190	7,408	2,492	2,589	5,351	8,772
Working capital (deficiency)	7,869	782	(578)	3,242	(1,116)	(142)
Total assets	$ 8,280	$ 10,870	$ 12,191	$ 19,028	$ 24,713	$ 32,490
Shareholders' equity	$ 8,102	$ 7,974	$ 7,840	$ 13,531	$ 12,531	$ 20,308
Shares outstanding						
Class A	7,953	7,953	7,963	11,063	11,063	13,594
Class B	739	739	739	739	739	739
Options	835	915	860	866	1,120	1,120
Warrants	320	320	320	320	320	320
Weighted shares outstanding						
Class A	5,634	7,953	7,955	8,406	11,063	12,267
Class B	321	739	739	739	739	739
Operating						
Average daily production						
Natural gas *(mcf/d)*	–	892	2,376	2,699	3,337	3,387
Crude oil *(bbls/d)*	–	34	87	58	89	138
NGLs *(bbls/d)*	–	32	52	60	82	61
Barrels of oil equivalent *(boe/d)*	–	215	535	568	727	763
Average selling price						
Natural gas *(mcf/d)*	–	5.87	7.94	7.13	6.19	5.75
Crude oil *($/bbl)*	–	40.97	48.17	37.92	37.07	36.95
NGLs *($/bbl)*	–	34.61	46.21	32.07	34.12	37.61

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The Management of Mustang Resources Inc. is responsible for the preparation of all information included in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect Management's best estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects. The financial information contained elsewhere in this Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management maintains appropriate systems of internal control that provide reasonable assurance that transactions are appropriately authorized, assets are safeguarded from loss or unauthorized use and financial records provide reliable and accurate information for the preparation of financial statements.

Collins Barrow Calgary LLP, an independent firm of chartered accountants, was appointed by the shareholders of Mustang Resources Inc. to audit the consolidated financial statements of the Corporation and provide an independent professional opinion. Their report is presented with the consolidated financial statements.

The Board of Directors, through its Audit Committee, has reviewed the consolidated financial statements including notes thereto with Management and Collins Barrow Calgary LLP. The members of the Audit Committee are composed of independent directors who are not employees of the Company. The Company's Board of Directors has approved the information contained in the consolidated financial statements based on the recommendation of the Audit Committee.

Richard A.M. Todd
President and Chief Executive Officer
April 23, 2004

Darcy R. Anderson
Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Mustang Resources Inc. as at December 31, 2003 and 2002 and the consolidated statements of operations and retained earnings and cash flows for the year ended December 31, 2003 and for the period from commencement of operations, July 1, 2002 to December 31, 2002. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion of these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the year ended December 31, 2003 and for the period from commencement of operations, July 1, 2002 to December 31, 2002 in accordance with Canadian generally accepted accounting principles.

[Signed] "Collins Barrow Calgary LLP"

Chartered Accountants, Calgary, Alberta
April 2, 2004

Consolidated Balance Sheets

as at December 31	2003	2002
Assets		
Current assets		
Cash and cash equivalents	**$ 4,873,636**	$ 2,107,876
Accounts receivable and prepaid deposits	**3,770,370**	1,269,541
	8,644,006	3,377,417
Property and equipment (NOTE 3)	**23,846,307**	7,492,880
	$ 32,490,313	$ 10,870,297
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 8,786,245**	$ 2,595,112
Provision for site restoration (NOTE 5)	**174,670**	23,000
Future income taxes (NOTE 6)	**3,221,542**	278,145
	12,182,457	2,896,257
Shareholders' Equity		
Share capital (NOTE 7)	**20,015,616**	7,944,860
Retained earnings	**292,240**	29,180
	20,307,856	7,974,040
	$ 32,490,313	$ 10,870,297

See accompanying notes to consolidated financial statements.

Approved by the Board,

R. Todd

Director

Director

Consolidated Statements of Operations and Retained Earnings

For the year ended December 31, 2003 and for the period from Commencement of Operations July 1, 2002 to December 31, 2002	2003	2002
Revenue		
Petroleum and natural gas sales	$ 9,351,043	$ 760,079
Royalties, net of Alberta Royalty Tax Credit	(2,066,352)	(122,033)
	7,284,691	638,046
Interest income	67,188	59,888
	7,351,879	697,934
Expenses		
Production	1,847,276	140,702
General and administrative	1,692,739	308,567
Interest	168,498	–
Depletion, depreciation and site restoration	3,065,300	178,800
	6,773,813	628,069
Earnings before income taxes	578,066	69,865
Income taxes (NOTE 6)		
Current income taxes	27,784	–
Future income taxes	287,222	40,685
	315,006	40,685
Net earnings	263,060	29,180
Retained earnings, beginning of period	29,180	–
Retained earnings, end of period	$ 292,240	$ 29,180
Net earnings per share (NOTE 8)		
Basic	$ 0.02	$ 0.00
Diluted	$ 0.02	$ 0.00

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

For the year ended December 31, 2003 and for the period from Commencement of Operations July 1, 2002 to December 31, 2002

	2003	2002
Cash provided by (used for)		
Operating activities		
Net earnings	$ **263,060**	$ 29,180
Add items not affecting cash		
Depletion, depreciation and site restoration	**3,065,300**	178,800
Future income taxes	**287,222**	40,685
Funds from operations	**3,615,582**	248,665
Changes in non-cash working capital		
Accounts receivable and prepaid deposits	**(1,426,683)**	(737,198)
Accounts payable and accrued liabilities	**1,174,009**	261,648
	3,362,908	(226,885)
Investing activities		
Expenditures on property and equipment	**(19,204,127)**	(7,598,680)
Site restoration and abandonment expenditures	**(62,930)**	–
Changes in non-cash working capital		
Accounts receivable and prepaid deposits	**(1,074,146)**	(532,343)
Accounts payable and accrued liabilities	**5,017,124**	2,333,464
	(15,324,079)	(5,797,559)
Financing activities		
Issuance of share capital	**15,948,500**	8,206,000
Share issuance costs	**(1,221,569)**	(793,681)
	14,726,931	7,412,319
Increase in cash and cash equivalents	**2,765,760**	1,387,875
Cash and cash equivalents, beginning of period	**2,107,876**	720,001
Cash and cash equivalents, end of period	$ **4,873,636**	$ 2,107,876
Cash and cash equivalents is comprised of:		
Balances with banks	$ **173,636**	$ 57,876
Short-term deposits	**4,700,000**	2,050,000
	$ **4,873,636**	$ 2,107,876
Supplemental cash flow information:		
Interest paid	$ **11,635**	$ –

In 2002, cash and cash equivalents beginning of period of $720,001, was from initial private capital that was issued prior to commencement of commercial operations.

Excluded from the consolidated statement of cash flows is the acquisition of property and equipment by issuance of share capital in the amount of $50,000 (note 7[d]).

See accompanying notes to consolidated financial statements.

December 31, 2003

1 Incorporation and Nature of Operations

Mustang Resources Inc. (the "Corporation") was incorporated under the laws of the Province of Alberta on March 13, 2002. The Corporation filed Articles of Amendment on June 19, 2002 amending its share capital to designate the Class A Common shares, Class B Common shares and Class C Preferred shares to Class A shares, Class B shares and Preferred Shares (Issuable in Series) and to vary the rights attaching thereto. On July 26, 2002 the Corporation filed Articles of Amendment to remove private Company provisions and share transfer restrictions. The Corporation is a public Company that trades on the TSX Venture Exchange and is engaged in the exploration for and development and production of petroleum and natural gas in Western Canada.

2 Significant Accounting Policies

(a) Principles of consolidation

The consolidated financial statements include, in addition to the accounts of the Corporation, the accounts of its wholly-owned subsidiary and partnership.

(b) Property and equipment

Capitalized costs

The Corporation follows the Canadian full cost method of accounting for petroleum and natural gas operations whereby all costs relating to the exploration for and the development of petroleum and natural gas properties and related reserves will be capitalized into a single Canadian cost centre. Such costs include those related to lease acquisition, geological and geophysical activities, lease rentals on non-producing properties, drilling of productive and non-productive wells, tangible production equipment, and that portion of general and administrative expenses directly attributable to exploration and development activities. Proceeds received from the disposal of properties are normally deducted from the full cost pool without recognition of a gain or loss, unless such a disposition would alter the rate of depletion and depreciation by 20% or more.

Depletion and depreciation

Depletion of petroleum and natural gas properties and depreciation of production equipment and facilities is calculated using the unit-of-production method based upon estimated proved reserves, before royalties, as determined by independent engineers. For purposes of the calculation, petroleum and natural gas reserves and production are converted to equivalent volumes based upon relative energy content whereby one barrel of oil equals six thousand cubic feet of natural gas. In determining its depletion base, the Corporation includes estimated future costs to be incurred in developing proved reserves and excludes the cost of undeveloped properties until it is determined that proved reserves are attributable to the property or impairment has occurred.

Future site restoration costs

The provision for estimated future site restoration costs is calculated on the unit-of-production method and is recorded in the statement of operations as a component of depletion and depreciation expense and on the balance sheet as a long-term liability. Actual abandonment and site restoration expenditures are charged to the accumulated provision account as incurred. Costs include the cost of production equipment removal and environmental cleanup based upon regulations and economic circumstances at period end.

Ceiling test

The Corporation applies a "ceiling test" which restricts the capitalized costs less accumulated depletion and depreciation to an amount equal to the estimated undiscounted value of future net revenues from production of proved reserves at year end product prices and undeveloped properties less future administrative, financing, site restoration, estimated future costs and income tax expenses.

Joint ventures

Substantially all of the Corporation's exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Corporation's proportionate interest in such activities.

Depreciation on other equipment

Depreciation is provided on other equipment at annual rates of 20% to 30% per annum on a declining balance basis.

(c) Cash and cash equivalents

Cash and cash equivalents consist of amounts on deposit with banks and investments in highly liquid short-term deposits.

(d) Income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values. Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on the tax laws and rates that are anticipated to apply in the period of realization.

(e) Stock-based compensation

The Corporation has a stock option plan as described in note 7(h).

The Corporation uses the "intrinsic value method" to account for options and warrants granted to employees, officers and directors whereby no compensation expense is recorded for stock options or warrants granted when the exercise price is greater than or equals the market price on the date of grant. The Corporation will disclose the pro forma results as if the "fair value method" was used to account for the grant of stock options and warrants to employees, officers and directors.

The Corporation accounts for all stock-based compensation arrangements with non-employees using the "fair value method". Under this method, the fair value of options and warrants granted are estimated at the date of grant using the Black-Scholes option pricing model. Compensation expense is recorded over the vesting period as general and administrative expense with a corresponding increase in contributed surplus. The contributed surplus balance is reduced as the options and warrants are exercised and the amount initially recorded is credited to share capital.

Consideration received by the Corporation on the exercise of stock options and warrants are recorded as share capital.

The Corporation has not incorporated an estimated forfeiture rate for stock options or warrants that will not vest, but accounts for actual forfeitures as they occur.

(f) Flow-through shares

The Corporation will, from time to time, issue flow-through shares to finance a portion of its petroleum and natural gas exploration program. Pursuant to the terms of flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, share capital will be reduced and a future tax liability will be recorded equal to the estimated amount of future income taxes payable by the Corporation as a result of the renunciations, when the expenditures are made.

(g) Per share information

Net earnings per share is calculated based on the weighted average number of Class A and Class B shares outstanding during the year. The diluted weighted average number of shares is adjusted for the dilutive effect of options, vested warrants and Class B shares. Under the treasury stock method, only "in the money" options are included in the weighted average diluted number of shares. It is also assumed that any proceeds obtained upon the exercise of options would be used to repurchase shares at the weighted average market price during the period. The weighted average number of shares is then reduced by the number of shares acquired. In addition, Class B shares are converted into Class A shares at $10 divided by the last 30 day weighted average price of the Class A shares.

(h) Revenue recognition

Revenue from the sale of petroleum and natural gas will be recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation and production-based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

(i) Risk management

The Corporation may enter into forward contracts to hedge its exposure to the risks associated with fluctuating petroleum and natural gas prices. The purpose of the contracts are to lock in the price for a portion of the Corporation's production. Gains and losses associated with risk management activities will be recorded as adjustments to the production revenue at the time the related production is sold.

(j) **Measurement uncertainty**

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and production equipment and facilities, the provision for future site restoration and abandonment costs and the ceiling test are based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions.

The amounts disclosed relating to fair values of stock options issued and warrants issued and the resultant pro forma income effects (note 7(h)) are based on estimates of future volatility of the Corporation's share price, expected lives of the options and warrants, expected dividends to be paid by the Corporation and other relevant assumptions.

By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements from changes in such estimates in future periods could be significant.

3 Property and Equipment

	Cost	Accumulated Depletion and Depreciation	Net Book Value
2003			
Petroleum and natural gas properties, including exploration and development thereon	**$ 23,164,142**	**$ 2,416,100**	**$ 20,748,042**
Production equipment and facilities	**3,512,599**	**532,200**	**2,980,399**
Other	**176,066**	**58,200**	**117,866**
	$ 26,852,807	**$ 3,006,500**	**$ 23,846,307**
2002			
Petroleum and natural gas properties, including exploration and development thereon	$ 6,240,866	$ 103,100	$ 6,137,766
Production equipment and facilities	1,276,588	33,200	1,243,388
Other	131,226	19,500	111,726
	$ 7,648,680	$ 155,800	$ 7,492,880

During the year ended December 31, 2003, the Corporation capitalized general and administrative expenses in the amount of $355,889 (2002 – $82,667) of total general and administrative expenses of $2,048,628 (2002 – $391,234). Costs of undeveloped land amounting to $2,107,000 (2002 – $1,697,000) have been excluded from the depletion and depreciation calculation.

4 Credit Facility

During the year, the Corporation increased its demand revolving production loan facility to a maximum of the lesser of $5,400,000 and the Borrowing Base as determined by the bank. The loan bears interest at a Canadian chartered bank's prime rate plus 1% per annum. The loan is secured by a General Security Agreement over all current and after acquired property of the Corporation and a fixed and floating charge debenture in the amount of $20,000,000 on all petroleum and natural gas present and future assets. As part of the loan agreement, the Corporation is required to meet certain reporting requirements and financial-based covenants. At December 31, 2003 the balance on the loan facility was $nil (2002 – $nil).

5 Site Restoration

As at December 31, 2003, the estimated future site restoration costs to be incurred over the life of the proved reserves are $2,067,000 (2002 – $1,262,000) of which $214,600 (2002 – $23,000) has been expensed in the current period. Actual payments for abandonment during the year ended December 31, 2003 were $62,930 (2002 – $nil).

6 Income Taxes

(a) Significant components of the future income tax liability at December 31, 2003 and 2002 include the following:

		2003		2002
Carrying value of property and equipment in excess of available tax deductions	$	**3,301,618**	$	720,830
Deferred partnership income		**703,464**		–
Future site restoration		**(62,881)**		(7,266)
Non-capital loss carryforward		**(124,739)**		(145,945)
Financing costs		**(534,362)**		(280,444)
Other		**(61,558)**		(9,030)
	$	**3,221,542**	$	278,145

(b) Income tax expense differs from that which would be expected from applying the effective combined Canadian federal and provincial 2003 income tax rates of 40.62% (2002 – 42.12%) to earnings before income taxes as follows:

		2003		2002
Expected income tax provision	$	**234,810**	$	29,427
Increase (decrease) resulting from:				
Non-deductible crown payments		**636,208**		45,439
Resource allowance		**(443,058)**		(26,319)
Alberta royalty tax credit		**(12,494)**		–
Impact of tax rate reductions		**88,308**		–
Provincial rebates		**(258,951)**		–
Large corporations tax		**27,784**		–
Other		**42,399**		(7,862)
Provision for income taxes	$	**315,006**	$	40,685
Large corporations tax	$	**27,784**	$	–
Future income taxes		**287,222**		40,685
	$	**315,006**	$	40,685

7 Share Capital

(a) Authorized

Unlimited number of voting Class A shares
Unlimited number of voting Class B shares
Unlimited number of Preferred Shares, issuable in series

(b) Issued and outstanding

	2003		2002	
	Number	Stated value $	Number	Stated value $
Class A Shares				
Balance, beginning of period	**7,953,001**	**1,590,601**	3,600,001	720,001
Issued under private placements (NOTE 7(C))	**5,631,250**	**15,945,000**	–	–
Exercise of stock options	**10,000**	**3,500**	–	–
Issued pursuant to public offering (NOTE 7(F))	–	–	4,103,000	820,600
Issued for property and equipment (NOTE 7(D))	–	–	250,000	50,000
Balance, end of period	**13,594,251**	**17,539,101**	7,953,001	1,590,601
Class B Shares				
Balance, beginning of period	**738,540**	**7,385,400**	–	–
Issued pursuant to public offering (NOTE 7(F))	–	–	738,540	7,385,400
Balance, end of period	**738,540**	**7,385,400**	738,540	7,385,400
Share issue costs, net of future income taxes of $439,764 (2002 – $334,299)		**(1,241,187)**		(459,382)
Tax effect of flow-through shares		**(3,667,698)**		(571,759)
Total share capital – end of period		**20,015,616**		7,944,860

(c) Private placements

On June 17, 2003, the Corporation closed a bought deal private placement whereby the Corporation issued 3,100,000 Class A shares at $1.95 per share for gross proceeds of $6,045,000.

On October 2, 2003, the Corporation closed a bought deal private placement whereby the Corporation issued 1,031,250 Class A shares on a flow-through basis at $3.20 per share for gross proceeds of $3,300,000 (Note 7(f)).

On December 19, 2003, the Corporation closed a bought deal private placement whereby the Corporation issued 1,500,000 Class A shares at $4.40 per share for gross proceeds of $6,600,000.

(d) Seismic Data Assignment and Novation Agreement

Pursuant to a Seismic Data Assignment and Novation Agreement dated May 27, 2002, with Balsam Energy Corp. ("Balsam"), the Corporation was assigned all interest and obligations under certain seismic agreements undertaken by Balsam (the "Seismic Agreements"). Balsam is a corporation with a common officer. The Seismic Agreements provide a non-exclusive license to use specified 3D seismic data, subject to certain terms and conditions.

In exchange, the Corporation issued 250,000 Class A Shares to certain officers (the "Officers") of the Corporation at an attributed value of $0.20 per share for total consideration of $50,000. This share issuance settled an obligation due by Balsam to the Officers for past geological and geophysical services rendered to Balsam. In addition, the Corporation will grant Balsam a 3% gross over-riding royalty on all petroleum and natural gas working interests obtained from the use of the 3D seismic data. This transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the Corporation and Balsam.

(e) Class B shares

The Class B shares will be convertible, at the option of the Corporation, at any time after December 31, 2005 and before December 31, 2007, into Class A shares. The number of Class A shares obtained upon conversion of each Class B share will be equal to $10.00 divided by the greater of $1.00 and the current market price of Class A shares. If conversion has not occurred by the close of business on December 31, 2007, the Class B shares become convertible (at the option of the shareholder) into Class A shares on the same basis. Any Class B shares outstanding on February 1, 2008 shall be automatically converted into Class A shares.

(f) Flow-through shares

On August 21, 2002, the Corporation sold 4,103,000 Class A shares on a flow-through basis at an issue price of $0.20 per share for gross proceeds of $820,600. The Corporation was committed to spend 100% of the funds on qualifying exploratory expenditures. As at December 31, 2002 the Corporation had renounced the full $820,600 and had actually spent $135,745. The remaining expenditures of $684,855 were incurred in 2003 and the resultant tax effect of $246,548 has been recorded as a reduction in share capital.

On August 21, 2002, the Corporation sold 738,540 Class B shares on a flow-through basis at an issue price of $10.00 per share for gross proceeds of $7,385,400. The Corporation was committed to spend 100% of the funds on qualifying exploratory expenditures. As at December 31, 2002 the Corporation had renounced the full $7,385,400 and had actually spent $1,221,708. The remaining expenditures of $6,163,692 were incurred in 2003 and the resultant tax effect of $2,218,929 has been recorded as a reduction in share capital.

On October 2, 2003, the Corporation sold 1,031,250 Class A shares on a flow-through basis at an issue price of $3.20 per share for gross proceeds of $3,300,000. The Corporation is committed to spend 100% of the funds on qualifying exploratory expenditures. As at December 31, 2003 the Corporation had renounced the full $3,300,000 and had spent a total of $1,751,284 and the resultant tax effect of $630,462 has been recorded as a reduction in share capital. The remaining $1,548,716 will be spent on its exploratory program in 2004 (note 10).

(g) Shares in escrow

Of the Class A shares issued to date, 2,160,000 shares are held in escrow and may not be released from escrow and traded without the written consent of the appropriate regulatory authorities. Every six months (next release being March 26, 2004), an additional 540,000 Class A shares will be released from escrow pursuant to the Escrow Agreement.

(h) Stock-based compensation

In accordance with the rules and policies of the TSX Venture Exchange ("TSX-V"), the directors, employees and consultants of the Corporation may be granted options to acquire shares of the Corporation. All options are granted in compliance with the requirements of the TSX-V. The maximum number of shares which may be reserved for issuance under the plan shall not exceed 10% of the aggregate issued and outstanding Class A and Class B shares of the Corporation from time to time. The exercise price and vesting terms of any options granted are fixed by the board of directors of the Corporation at the time of grant, subject to the limitations of the TSX-V. Options are non-assignable and non-transferable. The options vest 20% immediately, with a one year hold on the recipient's right to exercise the options granted, and thereafter 20% per year over a 4 year period. Options outstanding at December 31, 2003 expire between September 2007 and September 2008.

A summary of the status of the Corporation's outstanding stock options as at December 31, 2003 and 2002 and changes during the period then ended are as follows:

	2003		2002	
Outstanding stock options	Options #	Weighted average exercise price $	Options #	Weighted average exercise price $
Outstanding – beginning of period	**915,000**	**0.45**	–	–
Granted	**330,000**	**2.25**	915,000	0.45
Exercised	**(10,000)**	**0.35**	–	–
Cancelled	**(115,000)**	**0.35**	–	–
Outstanding – end of period	**1,120,000**	**0.99**	915,000	0.45
Exercisable – end of period	**316,000**	**0.46**	–	–

The following table summarizes additional information about the Corporation's outstanding stock options as at December 31, 2003:

	Outstanding stock options			Exercisable stock options	
Exercise price	Number	Weighted Average Remaining Term (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.35	710,000	3.7	$ 0.35	284,000	$ 0.35
$1.40 to $1.80	156,000	4.1	1.59	32,000	1.45
$2.35 to $2.60	254,000	4.6	2.40	–	–
Total	1,120,000	3.9	$ 0.99	316,000	$ 0.46

Subsequent to year-end, the Corporation granted 486,000 stock options to employees, officers and directors at an exercise price of $4.75 per option.

The Corporation accounts for its stock based compensation plans using the intrinsic value method whereby no compensation costs have been recognized in the financial statements for stock options and warrants granted to directors, officers and employees. If the fair value method had been used for options and warrants granted, the Corporation's compensation costs and net earnings (loss) and net earnings (loss) per share would approximate the following pro forma amounts:

Period ended December 31	**2003**	2002
Compensation costs	**$ 345,300**	$ 72,900
Net earnings (loss)		
As reported	**$ 263,060**	$ 29,180
Pro forma	**$ (82,240)**	$ (43,720)
Net earnings (loss) per share		
Basic		
As reported	**$ 0.02**	$ 0.00
Pro forma	**$ (0.01)**	$ (0.01)
Diluted		
As reported	**$ 0.02**	$ 0.00
Pro forma	**$ (0.01)**	$ 0.00

The fair value of each option and warrant granted is estimated on the date of grant or vesting using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

December 31	**2003**		2002
	Options	Warrants	
Risk free interest rate	**4.1%**	**2.5%**	4.5%
Expected hold period prior to exercise (years)	**5**	**1**	5
Expected volatility	**88%**	**94%**	70%
Dividend yield per share	–	–	–

The weighted average fair value of options granted during the period was $1.62 (2002 – $1.27) per option. The weighted average fair value of warrants vested during the period was $0.55 (2002 – $nil) per warrant.

(i) Warrants

In September 2002, the Corporation issued 320,000 warrants to two employees of the Corporation. Each warrant is exercisable into one Class A share of the Corporation at an exercise price of $1.50 per share. Each employee's right to subscribe for and purchase Class A shares shall be subject to the Corporation satisfying, on or before each target date set forth in the table below, the corresponding production target. The following warrants are presently outstanding:

Production Target	Target Date	Number of Warrants Vested *(Note)*
300 BOE per day	18 months after August 21, 2002	80,000
600 BOE per day	18 months after August 21, 2002	80,000
900 BOE per day	24 months after August 21, 2002	80,000
1,200 BOE per day	30 months after August 21, 2002	80,000

Note: In order for the Warrants to vest, the full cycle finding and development ("F&D") cost of production must be equal or less than $7.50 per BOE of total proved reserves plus half probable reserves, as determined by independent engineers of the Corporation.

The Corporation's production for the purposes of assessing whether a production target has been satisfied is equal to the aggregate average production of all wells resulting from new drilling of exploration and development locations located in the Seismic Areas, as such term is defined in the Seismic Data Assignment and Novation Agreement between Balsam Energy Corp. and Mustang Resources Inc. (see note 7(d)). For greater certainty, all production derived from any infill locations on existing pools located in the Seismic areas are excluded from the calculation of production. Production shall be measured over any six-month period preceding the applicable Target Date and shall be based on the Company's net working interest production in barrels of oil equivalent of natural gas and crude oil on the basis of one barrel of oil equivalent for ten thousand cubic feet of natural gas ("BOE"). The vesting of the Warrants is not cumulative. The rights earned to purchase Class A shares shall expire twelve months from the date on which the Warrants vest.

On February 21, 2004, 160,000 of the warrants were vested. The vested warrants are not exercisable by the employees until the December 31, 2004 reserve report verifies that the full cycle F&D cost of $7.50 per BOE has been reached. As such the Corporation has disclosed a pro forma amount for stock-based compensation expense for the vested warrants as noted in note 7(h).

(j) Employee stock savings plan

On January 1, 2002, the Corporation initiated an employee stock savings plan (the "ESSP"). Employees of the Corporation may contribute a percentage of their regular salary to the ESSP ranging up to 10% excluding bonuses. The maximum 10% limit will be increased by 1% for each additional year of employment with the Corporation, up to a maximum of 15%. The Corporation contributes an amount equal to 150% of the employee's contribution up to a maximum of 20% of the employee's regular salary for a given pay period, which contribution is combined with the employee's contribution to acquire Class A shares of the Corporation.

The amounts incurred by the Corporation under the ESSP are recorded as additional general and administrative expense.

8 Per Share Amounts

Per share amounts have been calculated on the weighted average number of shares outstanding during the period. The weighted average number of shares outstanding for the period ended December 31, 2003 was 10,676,205 (2002 – 7,323,280).

In computing diluted net earnings per share amounts, 1,662,963 (2002 – 2,893,152) shares were added to the weighted average number of shares outstanding during the period ended December 31, 2003 for the dilutive effect of employee stock options, employee warrants and Class B shares.

The following reconciles the denominators for basic and diluted net earnings per share calculations:

	Net earnings (numerator)	Weighted Average shares (denominator)	Per Share
Class A shares		9,937,665	
Class B shares		738,540	
Basic net earnings per share	$ 263,060	10,676,205	$ 0.02
Dilutive securities:			
Conversion of Class B shares		916,353	
Options		678,942	
Warrants		67,668	
Diluted net earnings per share	$ 263,060	12,339,168	$ 0.02

9 Financial Instruments

(a) Fair values

The fair values of the Corporation's accounts receivables, accounts payable and accrued liabilities approximate their carrying values due to the short-term nature of these financial instruments.

(b) Credit risk

Virtually all of the Corporation's accounts receivables are with customers in the petroleum and natural gas industry and are subject to normal industry credit risks. The carrying value of accounts receivable reflects management's assessment of the associated credit risks.

(c) Risk management

The Corporation did not enter into any derivative financial instruments designated as hedges during 2003 or 2002 and has no outstanding derivative financial instruments designated as hedges as at December 31, 2003.

10 Commitments

(a) The Corporation is committed to spending $1,548,716 on qualifying exploratory expenditures relating to various flow-through agreements (note 7(f)).

(b) The Company is committed to payments for office space as follows:

Calendar Year	Amount $
2004	127,000
2005	149,000
2006	89,000
Total	365,000

In addition, the Company is required to pay its share of operating expenses and taxes, for the duration of the office lease.

11 Subsequent Events

(a) Private Placement

On February 19, 2004, the Corporation closed a bought deal private placement whereby the Corporation issued 2,000,000 Class A shares at $4.50 per share for gross proceeds of $9,000,000.

(b) Property Acquisition

On February 23, 2004, the Corporation acquired certain producing petroleum and natural gas properties in Medicine River, Alberta for approximately $12.5 million. The effective date was February 1, 2004, however this transaction has been accounted for as of the closing date, February 23, 2004. The acquisition was funded through the February 19, 2004 private placement and the Corporation's credit facility.

12 Comparative Figure

Certain comparative figures have been reclassified to conform to the current year's presentation.

Corporate Information

DIRECTORS

Richard A.M. Todd
Chairman

Donald Archibald (1) (3)

Bill Friley Jr. (1) (2) (3)

Kel Johnston (1) (2) (3)

OFFICERS AND MANAGEMENT

Richard A.M. Todd
President and Chief Executive Officer

Darcy Anderson
Chief Financial Officer

Kevin Angus
Vice-President, Exploration

Glenn Booth
Vice-President, Land

Patrick Mills
Vice-President, Engineering and Operations

Darren Steffes
Chief Geologist

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INVESTOR RELATIONS

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Darcy Anderson
Chief Financial Officer
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MUSTANG ABBREVIATIONS

bbls	barrels
mbbls	thousand barrels
mcf	thousand cubic feet
mmcf	million cubic feet
boe	barrel of oil equivalent (6 mcf = 1 bbl)
mboe	thousand boe
/d	per day
m	metre
bcf	billion cubic feet
mmbtu	million British thermal units
AOF	Absolute open flow
GJ	gigajoules
ARTC	Alberta Royalty Tax Credit
W.I.	Working Interest

(1) Member of the Audit Committee of the Board of Directors
(2) Member of the Compensation Committee of the Board of Directors
(3) Member of the Reserve Committee of the Board of Directors

Banker
Alberta Treasury Branch
Calgary, Alberta

Auditor
Collins Barrow Calgary LLP
Calgary, Alberta

Legal Counsel
McCarthy Tétrault LLP
Calgary, Alberta

Evaluation Engineers
McDaniel & Associates Consultants Ltd.
Calgary, Alberta

Registrar and Transfer Agent
Valiant Trust Company
Calgary, Alberta

Stock Exchange
TSX Venture Exchange

Stock Symbols
MUS.A and MUS.B

Shares Outstanding
Class A – 15,834,251
Class B – 738,540

Designed and produced by Ge-ko Communications Inc. and Pfang Creative Inc.

Mustang Resources Inc.

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